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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

No. [redacted]

PERMIAN BASIN PIPELINE COMPANY,
a Corporation,
Appellant,

v.

RAILROAD COMMISSION OF TEXAS
and THE ATLANTIC REFINING COMPANY,
a Corporation,
Appellees.

On Appeal From the Court of Civil Appeals for the Third Supreme Judicial District of Texas, at Austin

BRIEF IN SUPPORT OF APPELLEES' MOTION TO DISMISS OR TO AFFIRM

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BRIEF IN SUPPORT OF APPELLEES' MOTION TO DISMISS OR TO AFFIRM

No federal question of substance is presented; the appeal is frivolous and should be dismissed or the judgment below affirmed. The question at issue, not a federal question, is whether the production of gas from a Texas gas field is to be prorated by the State of Texas or by an interstate carrier of natural

gas. As shown at pp. 6-10, *post*, the challenged statute and orders are concerned only with production and not at all with price.

I.

The challenged statute and orders do not conflict with any jurisdiction conferred upon the Federal Power Commission by the Federal Natural Gas Act.

For logical reasons we will consider first the local interests involved; but if the Court desires to be apprised immediately of the limited impact of the statute and orders, an impact having nothing whatsoever to do with federal jurisdiction, we call the Court's attention to what is set forth under the second subhead, pp. 6-10, *post*.

(1) *The purely local interests protected by the challenged statute and orders.*

It is common knowledge that the market for oil or gas lies in the field; is supplied by the pipeline serving the field or by a purchaser affiliated with such pipeline. Left to its own devices the pipeline or the purchaser affiliated therewith will effectively *prorate* the oil or gas from the field by determining from what producers, and in what relative amounts, oil or gas will be purchased by it.

As has been well said:

"For the independent producer, the pipeline performs a double function: It furnishes transportation at a cost much lower than railroad freight, and *it*

brings the market for crude oil directly to the producing property." (Economics of Pipe-Line Transportation in the Petroleum Industry, Joseph E. Pogue, p. 731.)

Years ago a member of the Railroad Commission of Texas* said this about the necessity for regulation of purchasers:

"Pipe lines prorate fields themselves. The reason is this: In most instances the company that owns the pipe line also purchases the oil in the field. Through the control of the pipe line you absolutely control the production, in the new fields, where only one pipe line is connected with the field. It costs a good deal of money to build another pipe line, unless there is a very large production, *and the individual producer, without the aid of the State, is wholly at the mercy of the pipe line."* (Hearings Before a Subcommittee of the Committee on Interstate and Foreign Commerce, 73rd Congress, part 4, pp. 1806-1807.)

While the foregoing has reference to the purchase of oil, it is equally applicable to the purchase of gas.

In the absence of regulation of purchasers the following evils may result:

(a) Monopoly may be created by the action of the purchaser in taking only its own production or the production of an affiliated corporation; or by purchasing from a favored group of producers only.

(b) Cross lease drainage of oil or gas may be caused. If the purchaser will take oil or gas from

* Hereinafter called the "Railroad Commission".

A but not from B, thereby allowing A to produce his wells while B's wells are shut in, oil or gas will be drained from beneath B's lease to A's lease.

(c) In an instance where oil production is involved, the producer who has no market will attempt to produce his oil and retain it in aboveground storage, thereby causing aboveground physical waste due to evaporation, seepage, *etc.* In the instance of gas production, the producer who has no market will be tempted to extract the liquid content from the gas and to flare the residue gas or to use the gas in the manufacture of carbon black or to make some other inferior use of it.

For consideration of these problems by this Court, see *Champlin Refining Co. v. Corporation Commission*, 286 U. S. 210, and *Thompson v. Consolidated Gas Co.*, 300 U. S. 55.

Insofar as the production of gas is concerned, the State of Texas has proceeded in three ways to prevent the above described evils. It has enacted legislation prohibiting the venting or flaring of gas and requiring gas to be used for certain purposes; and requiring the Railroad Commission to prorate the gas produced from each gas field "so as to give each well its fair share of the gas to be produced from the reservoir." Article 6008, *Vernon's Texas Statutes.** It has adopted the Common Purchaser Act, an Act requiring each purchaser of gas to purchase

* The last official codification of Texas statutes was made in 1925; and the statutes pertinent to the instant case were enacted after that date. Consequently, reference will be made to the unofficial publication used by the Texas courts.

ratably. Article 6049a, *Vernon's Texas Statutes.* (Jurisdictional Statement, Appendix E.)

The Common Purchaser Act complements the legislation requiring the Railroad Commission to prorate production of gas "so as to give each well its fair share of the gas to be produced from the reservoir." Since the producer may not flare his gas after extracting its liquid content; may not manufacture carbon black therefrom or make other inferior use thereof; and may not sell his gas for such use, a Railroad Commission order prorating production is of no benefit to the producer unless he can share in the market for gas that will be used for a permitted purpose, usually a fuel market. Consequently, the Common Purchaser Act, like legislalation requiring the Railroad Commission to prorate gas, has but one objective—to insure to each producer an opportunity *to produce* his fair share of the total gas produced from the field. And this objective is subsidiary to the primary goal of conserving the State's natural resources.

That statutes requiring purchasers to purchase ratably are in essence statutes *insuring ratable production* in the interest of preventing physical waste has been recognized by an eminent authority in the field of oil and gas law:

"Statutes making pipe line companies common purchasers of oil and gas are, in purpose and effect, *conservation* measures, and so operate, whether the production of oil or gas from a common source of supply is or is not restricted and prorated among the wells therein for the prevention of waste. Courts in most of the oil and gas producing states have held

that a state may validly legislate for the prevention of waste of oil and gas and for the protection of the correlative rights of owners and lessees in a common source of supply. Legislative enactments and judicial opinions have repeatedly stated that conservation measures and the orders and regulations of conservation agencies should be such as to afford the owner of each tract of land in a common source of supply of oil or gas the opportunity *to produce* his just and equitable share of the oil or gas therein and to use therefor his just and equitable share of the reservoir energy. Unless all the producers in a common source of supply have equal opportunity to sell or to transport oil and gas from their wells, they are not afforded the opportunity *to produce* their just and equitable share of the oil or gas or to utilize their just and equitable share of the reservoir energy. The purpose of the common purchaser statutes, and in some measure the purpose of the common carrier statutes, is to afford this opportunity." (4 Summers, *The Law of Oil and Gas*, perm. ed., Sec. 754, p. 182.)

It is almost self-evident that the Common Purchaser Act and any orders entered under it are directed at the regulation of *production* and with nothing else.

(2) *The limited scope of the Common Purchaser Act and of the orders of the Railroad Commission entered thereunder.*

The statute and orders of the Railroad Commission entered thereunder do *not*:

(a) Compel Permian Basin Pipeline Company* to purchase any gas, even one cubic foot thereof.

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* Hereinafter called "Permian".

(b) Compel Permian to purchase a specified quantity of gas if it should choose to purchase; Permian may purchase one million cubic feet per day or two hundred million cubic feet per day, as it chooses. It may purchase one million cubic feet today and forty million cubic feet tomorrow.

(c) Require Permian to pay a specified price for the gas it purchases. Neither the statute nor the orders of the Railroad Commission mention "price". The price paid for the gas by Permian has been fixed by the Federal Power Commission.*

The statute and orders merely require Permian to purchase *ratably* such gas at is chooses to purchase, at such price as has been or may be fixed by the FPC.

Permian contends that the Railroad Commission "may, by indirection, effectively require Permian to enlarge its Mitchell CO_2 plant by compelling it to purchase or take gas from other producers." (Jurisdictional Statement, p. 19.) This statement is incorrect. The statute and orders of the Commission do not require Permian to purchase even one cubic foot of gas; insofar as the statute and orders are concerned, Permian may daily purchase no gas, one cubic foot of gas or one billion cubic feet of gas. Since the size of Permian's plant is directly related to the amount of gas purchased by Permian and since Permian has absolute control over the amount of gas purchased by it, it is self-evident that the statute and orders of the Commission do not directly or indirectly compel Permian to enlarge its plant.

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* Hereinafter referred to as the "FPC".

Permian also asserts that under the Common Purchaser Act the Railroad Commission "can require Permian to extend its pipeline system to purchase or take additional supplies of gas from the producers." (Jurisdictional Statement, p. 19.) Since the orders of the Railroad Commission here involved do not purport to require Permian "to extend its pipeline system" there is no occasion for appellees to discuss the validity of a hypothetical order requiring such action by Permian.

Permian asserts that the orders of the Railroad Commission require it to purchase gas "without discrimination as to price." (Jurisdictional Statement, pp. 2, 6, 11.) This assertion has no basis whatsoever in fact; the prices paid by Permian are those that have been fixed by the FPC. The word "price" does not appear in the orders of the Railroad Commission and its orders have nothing whatsoever to do with the price Permian pays for the gas purchased by it.

Nor is the statute under which the Railroad Commission acted in any way concerned with "prices". It does require a common purchaser to purchase "without discrimination", and in instances where the FPC cannot exercise its price fixing jurisdiction, *e. g.*, in the instance of a sale of gas not going into interstate commerce, the price paid by a common purchaser to producers of gas in the *same* field presumptively should be the same. In this way "discrimination" in purchases would be avoided. But in instances where the FPC has jurisdiction the price fixed by the FPC controls.

And even in those instances where the FPC has no jurisdiction to fix prices, neither the statute nor the orders of the Railroad Commission fix the price to be paid by the purchaser. Such price is determined by the purchaser, it being logical to assume, with respect to intrastate gas, that the same price would be paid all producers in the *same* field, whether it be one cent per mcf or twenty cents per mcf.

Permian quotes the following from a brief filed by appellees in the Supreme Court of Texas:

"* * * The Common Purchaser Act requires the purchaser to take without discrimination, that is, to pay each producer in the same field the same price for the same kind of gas. Contracts to the contrary are invalid." *

What Permian fails to state is that such quotation had reference to purchases made by a common purchaser that is not subject to regulation by the FPC as to price. As to purchasers that are subject to the jurisdiction of the FPC appellees stated:

"For purposes of this case respondents admit that the price of the gas to be paid by Permian is subject to control by the FPC. We further admit for the purposes of this case that while it is inconceivable that it would do so, the FPC might fix one price to be paid for the gas purchased by Permian from Phillips and another price to be paid for the gas purchased

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* Respondents' Answer to Application for Writ of Error, p. 53.

by Permian from Atlantic. If the FPC did so there would be reasonable ground for the difference in price, with the consequence that Permian by complying with the orders of the FPC with respect to price would not be guilty of discrimination.

"The long and the short of the matter is that insofar as this case is concerned, the price to be paid for the gas by Permian has been fixed by the FPC; the Commission has not attempted to fix any price; all the Commission has done is order Permian to purchase ratably *at the price fixed by the FPC.*"*

Permian asserts that the Common Purchaser Act "contemplates and requires that the Railroad Commission *regulate the price* at which Permian now or hereafter purchases gas"; and that "it cannot be successfully disputed that the Common Purchaser Act contemplates and requires state enforcement of minimum prices." (Jurisdictional Statement, pp. 17, 18.) These assertions are not supported by anything in the statute, in the orders of the Commission or in the evidence. Insofar as the statute, orders and evidence are concerned, Permian is at liberty to pay for the gas purchased by it *any* price fixed by the FPC whether such price be one cent per mcf or one dollar per mcf. Moreover, if at any time the price paid Permian for the gas should not be subject to the control of the FPC, Permian would be perfectly free to set any price it desired. The statute and the Commission's orders are not concerned with minimum price or maximum price; are not concerned with price in any way whatsoever.

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* Respondents' Answer to Application for Writ of Error, pp. 84-5.

(3) *Since the challenged statute and orders merely control gas production and have nothing whatsoever to do with the price paid for gas by Permian, they operate in the field of jurisdiction expressly left to the States by the Federal Natural Gas Act.*

In an effort to insure each producer of gas from the field an opportunity to produce his fair share of the total gas produced therefrom, the Railroad Commission, proceeding under the provisions of Article 6008, *supra*, first adopted field rules allocating gas production among the various gas wells in the field upon the basis of gross acre feet of pay assigned to each well multiplied by the reservoir pressure thereof, admittedly an attempt to allow each fully developed lease to be produced in proportion to its gas reserves. (R. 22-4, 252.) If each gas well had produced the gas so allocated to it or the same proportion thereof and if Permian had purchased such gas, no inequity would have resulted.

But Permian chose to purchase from Phillips Petroleum Company* nearly all the gas purchased by Permian in the field. As a result, during the period from September, 1955, to October, 1956, Atlantic's Robbins "A" No. 1 well produced 157,787,000 cubic feet of gas as a prorated well; whereas, its share of *actual* production from prorated wells during this period of time as determined by use of the Railroad Commission's allocation formula was 1,328,030,000 cubic feet of gas. In other words, this well failed by 1,170,243,000 cubic feet of gas

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* Hereinafter referred to as "Phillips".

(1,328,030,000 cubic feet minus 157,787,000 cubic feet) to produce its share of the gas actually produced from prorated wells in the field. During this same period of time Phillips' wells actually produced an amount of gas that *exceeded* by 1,170,243,000 cubic feet such wells' share of *actual* production from prorated wells as determined by reference to the Commission's allocation formula. (R. 192-4, 199-200, 470.)

The 1,170,243,000 cubic feet of gas the Robbins "A" No. 1 well did *not* produce during the period from September, 1955, to October, 1956, would have yielded $70,214.58 if produced and sold at the price of six cents per mcf fixed by Permian. (R. 158, 181, 200-1, 288-9.)

During the foregoing period substantial quantities of gas were drained from beneath Atlantic's Robbins "A" lease to the leases owned by Phillips as the result of the production by Phillips of far more than its share of the gas produced from the field. (R. 249-254.)

To correct the intolerable situation above described the Commission entered the orders under attack. These orders correct the inequity in production (1) by *limiting* Phillips' production from its wells to a certain proportion, its fair share, *of the gas daily produced from the field,* which means in practical effect the gas daily purchased by Permian; and (2) by requiring Permian, if it purchases any gas, to purchase gas from *all* producers and to purchase such gas *ratably.* (R. 29-30.)

It will be noted that (1) and (2) reach the same end. If Permian desires to take gas, as it admittedly

does, and if Phillips' daily production is *limited* to a certain percentage *of the gas daily produced from the field*, Permian will be forced to purchase gas from the other operators in the field if it purchases from Phillips. Otherwise Phillips' daily production will not be a fixed percentage of *total* production. Basically, then, the issue presented is whether the Railroad Commission has the power to do what it has been doing for years in the gas fields of Texas—to so *prorate* gas production as to give each operator the opportunity to *produce* his fair share of the total gas produced from the field.

That the Natural Gas Act is concerned with *rates* or *charges*, 15 *U. S. C. A.*, Sec. 717c (a), and that the act is not concerned with local matters, such as production, is made plain by paragraph (b) of Section 717, reading:

"The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the *production* or gathering of natural gas."

In *Interstate Natural Gas Co. v. Federal Power Commission*, 331 U. S 682, this Court said:

"* * * In denying the Federal Power Commission jurisdiction to regulate the production or gather-

ing of natural gas, it was not the purpose of Congress to free companies such as petitioner from effective public control. The purpose of that restriction was, rather, to preserve in the States powers of regulation in areas in which the States are constitutionally competent to act. Thus the House Committee Report states: 'The bill takes no authority from State commissions, and is so drawn as to complement and in no manner usurp State regulatory authority. . . .' Clearly, among the powers thus reserved to the States *is the power to regulate the physical production and gathering of natural gas in the interests of conservation or of any other consideration of legitimate local concern.*" (331 U. S. 690.)

Here the sole objective of the Railroad Commission's orders is *ratable production*. References to the Common Purchaser Act and to the purchase of gas are for the sole purpose, not of fixing the *price* for which the gas is purchased or of fixing the *amount* of gas that is to be purchased, but to insure ratable production. As shown above, the references to the Common Purchaser Act are in reality superfluous; the Railroad Commission eliminated the inequity in production by limiting Phillips' production from its wells to its fair share of the gas daily produced from the field. Those provisions in the orders requiring Permian to purchase ratably *do no more* than the provisions of the orders limiting the production from Phillips' wells.

Permian refers to the certificates of public convenience and necessity granted by the FPC to Phillips and Atlantic (Jurisdictional Statement, pp. 14-15), such certificates being required by the FPC of any producer selling gas to an interstate pipeline,

such requirements being based upon this Court's opinion in *Phillips Petroleum Company v. Wisconsin*, 347 U. S. 672. None of such certificates makes any reference to the *amount* of gas to be sold and purchased in the field. The certificates were granted pursuant to the filing with the FPC of the contracts under which the gas is sold, such contracts being filed as *rate schedules*. In this connection this quotation from the certificate granted Atlantic is pertinent:

"This authorization and the acceptance of the above *rate schedule* are without prejudice to such final disposition of the application for certificate as the record may require." (R. 348-9.)

In truth and in fact, the producers were required to obtain their certificates because of the jurisdiction conferred upon the FPC with respect to *rates*. The FPC has no interest in and has no jurisdiction over the *amounts* of gas purchased from the producers by Permian and has no interest in nor jurisdiction over the matter of whether Permian shall purchase ratably, that is, from all producers, or non-ratably.

The FPC is interested in one question and only in one question: Is the price Permian pays for gas produced from the Puckett-Ellenberger field and passed on to the ultimate consumer a fair and reasonable price? If it is, Permian may purchase from whom it pleases and in such amounts as it pleases. Permian has not pointed to and cannot point to any rule, regulation or order of the FPC indicating any intention to *select* the producers from whom Permian pur-

chases or any intention to fix the *amounts* of gas Permian purchases from each producer. That is a purely local matter left to the jurisdiction of the State of Texas acting through the Railroad Commission.

II.

The statutes and orders complained of do not deprive Permian of any rights guaranteed it by the Federal Constitution.

The contention that the statute and orders complained of deprive Permian of property and contractual rights in violation of the due process clause of the Federal Constitution is, if possible, even more frivolous than the contention that the statute and orders conflict with jurisdiction conferred upon the FPC by the Federal Natural Gas Act. *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U. S. 179. In that case this Court upheld orders of the Oklahoma Corporation Commission fixing a minimum wellhead price for gas taken from the Guymon-Hugoton field and directing Cities Service to take gas ratably from Peerless at the price fixed. In upholding these orders this Court stated that the "Due Process and Equal Protection issues raised by appellant are virtually without substance." (340 U. S. 185.)

Since the statute and orders here involved do not fix the price to be paid by Permian for the gas purchased by it but only compel Permian to purchase gas ratably, the attack against them is much more frivolous than the attack leveled against the orders

involved in the *Cities Service Gas Company* case. It is the element of price that distinguishes the *Cities Service Gas Company* case from *Cities Service Gas Company v. State Corporation Commission of Kansas*, Oct. Term, 1957, ... U. S. ....., 78 S. Ct. 381, a case in which the order of the Kansas Commission was struck down because it attempted *to fix price*, a matter within the jurisdiction of the FPC.

WHEREFORE, appellees pray that the appeal be dismissed or, in the alternative, that the judgment below be affirmed.

Respectfully submitted,

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